


Office of  
The City Attorney  
City of San Diego

MEMORANDUM

DATE: April 21, 2008   
TO: Council President Peters and Members of the City Council  
FROM: Michael J. Aguirre, City Attorney  
SUBJECT: Deferred Maintenance Financing (Item 331)

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On April 22, 2008, the City Council will consider an Ordinance to authorize the issuance of not to exceed \$108,000,000 aggregate principal amount of Public Facilities Financing Authority Lease Revenue Bonds [the Bonds] to finance certain deferred maintenance needs of the City. The financing structure contemplates a lease-lease back arrangement in which the subject matter of the lease (i.e. the "Leased Property", as further described below) receive no benefit of the proceeds of the bonds. The transaction is described in greater detail in the Report to Council, Report No. 08-041, dated March 26, 2008 [Report]. For the reasons stated below, it is the opinion of the City Attorney that the proposed financing violates the debt limit of the State constitution and the City Charter, and therefore must be subject to an approving 2/3rds vote of the electorate.

Under California Constitution, Article XVI § 18 and City Charter, Article VII, § 99, City officials cannot borrow from future year revenues to pay bills from earlier years without a vote of the people. The Constitution and City Charter provide in pertinent part:

No... City...*shall incur any indebtedness or liability in any manner* or for any purpose *exceeding in any year the income and revenue provided for such year, without the assent of two-thirds of the voters of the public* entity voting at an election to be held for that purpose.... Cal. Const., Art. XVI, § 18(a) (emphasis added).

The City *shall not incur any indebtedness or liability in any manner* or for any purpose *exceeding in any year the income and revenue provided for such year unless the qualified electors of the City, voting at an election to be held for that purpose, have indicated their assent* as then required by the Constitution of the State of California.... San Diego City Charter, Article VII, § 99 (emphasis added).

The financing structure is as follows. The City will lease the Leased Property (consisting of the Police Headquarters, the Rose Canyon Operations Station, the Mission Valley Library, the Malcolm X Library and the Scripps Ranch Library, and referred to in the Site Lease) to the Authority for a nominal rental amount and the City will lease the Leased Property back from the Authority for the fair market rental value of the properties. City lease payments to the Authority will be used to pay the debt service on the Bonds. The City will covenant to appropriate annually the necessary moneys to make the rental payments. The Bonds are intended as an interim financing and the City intends to refund the Bonds in two years through the public issuance of long term bonds. Consequently, the Bonds have a two-tiered interest rate structure, with an initial fixed rate for the first two years and a subsequent higher fixed rate (to be determined) from the third year to maturity. The City would also be required to begin paying principal and interest on the Bonds after the first two years of interest only payments.

We requested a continuance at the April 7, 2008 Council meeting on this matter to further review the proposed legal structure. We have received, and reviewed, a memorandum dated April 21, 2008 from Hawkins Delafield & Wood LLP purporting to analyze the legality of the transaction [Hawkin's Memorandum, attached hereto as Exhibit A]. Our research has found no case in which a California court has approved the type of transaction herein contemplated. We are aware that courts have approved other forms of lease transactions (see e.g., *Rider v. City of San Diego* 18 Cal. 4<sup>th</sup> 1035) as exceptions to the debt limit. But we have been unable to locate a case in which the City is permitted, in effect, to take out a mortgage on City property and use the proceeds to pay for deferred maintenance of the City. Without such authority, the office of the City Attorney would be unable to deliver its opinion that the Bonds are "duly authorized" given the specific language of the debt limit provisions of City's Charter and the State constitution. We therefore believe that the prudent course necessitates that the City obtain voter approval of the Bonds. The debt limit provisions are designed to prevent the accumulation of indebtedness without the assent of those who would be obligated to pay for such indebtedness. In effect, local entities, such as the City, must operate on a pay-as-you-go basis, absent a waiver approved by two-thirds of the voters. The current proposal seeks to borrow \$108 million repayable from future taxes---in other words, money that is not currently in City hands today---without a vote of the electorate.

The proposed legal structure is simply a legal fiction, a structure by design intended to work around the debt limit. Not only does the proposed structure violate the plain language and spirit of the debt limit, it also subjects taxpayers, and a future City Council, to the risk of paying unaffordable interest rates on the Bonds (up to 12%) when such interest rates adjust in two years (assuming the City does not pursue a long-term take out of the financing). Alternatively, if the City cannot either pay debt service or provide long term financing for the Bonds, the City has put at risk its police headquarters and libraries at risk to pay for deferred maintenance expenses of the City, costs that should be paid for out of cash on a year-by-year basis.

The City Attorney has carefully reviewed and considered the Hawkin's Memorandum, and observes that it too has located no definitive binding legal authority. While the memorandum cites other legal authority as persuasive, the office of the City Attorney believes that if the proposed financing is permitted then the debt limit has little or no meaning and its observance little more than a shallow ceremony. Thus, it is the opinion of the City Attorney that the Bonds must be approved by the voters especially when, as here, the subject matter of the proposed lease is not the beneficiary of the bond proceeds.

MDB:jdf

cc: Jerry Sanders, Mayor  
Andrea Tevlin, Independent Budget Analyst  
Jay Goldstone, COO  
Mary Lewis, CFO